Supreme Court, U.S.
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No. 86-1652

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1986

LIQUID TRANSPORTERS, INC. - - Appellant

versus

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - Appellee

On Appeal from the Court of Appeals of Kentucky

MOTION TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

1. Has Liquid Transporters failed to show that the decision was not or could not be decided on an adequate non-federal basis?

2. Has Liquid Transporters failed to present before this Court grounds to show a substantial question of constitutional law?

TABLE OF CONTENTS

	PAGE
Questions Presented	i
Table of Authorities	iii
I. The State Law Involved and the Nature of the Case	1– 4
A. The Relevant Statutes and Regulations	1– 3
B. The Proceedings Below	3– 4
II. Arguments	5– 8
1. No Right of Review by the Court Will be Granted When the Case at Issue Was or Could be Decided on an Adequate, Non-Federal Basis	5– 6
2. This Case Presents No Substantial Federal Question Not Previously Decided by This Court	6– 8
III. Conclusion	9
Appendix:	
Appendix	1a–31a
A. KRS 141.120	1a– 6a
B. 103 KAR 16:120	7a– 8a
C. Opinion—Kentucky Board of Tax Appeals	9a–15a
D. Judgment—Jefferson Circuit Court	16a–23a
E. Opinion—Court of Appeals of Kentucky	24a–30a
F. Order—Supreme Court of Kentucky	31a

TABLE OF AUTHORITIES

Federal Cases: PAGE

Central Greyhound Lines, Inc. of New York v. *Carroll E. Mealey,* 334 U. S. 653 (1948) 7, 8

Container Corporation of America v. *Franchise Tax Board,* 463 U. S. 159 (1983) 7

Hans Rees' Sons, Inc. v. *North Carolina,* 283 U. S. 123 (1931) 7

Jean v. *Nelson,* 105 S. Ct. 2992 (1985) 6

M'Culloch v. *Maryland,* 17 U. S. (4 Wheat.) 316 (1819) 6

Moorman Manufacturing Company v. *G. D. Bair,* 437 U. S. 267 (1978) 7

Wisconsin v. *J. C. Penney Company,* 311 U. S. 435 (1940) 6

State:

Liquid Transporters, Inc. v. *Revenue Cabinet,* 721 S. W. 2d 722 (Ky. 1986) 5

Constitution:

U. S. Const., Art. 1, § 8 cl. 3 6

U. S. Const., Amend XIV, § 1 6

Statutes:

Kentucky Revised Statute 141.120 ..... 1, 5

Regulations:

103 Kentucky Administrative Regulation 16:090 .. 2

103 Kentucky Administrative Regulation 16:120 .. 2

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v.

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - *Appellee*

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

MOTION TO DISMISS OR AFFIRM

The Appellee, Revenue Cabinet, Commonwealth of Kentucky, respectfully moves to dismiss the appeal herein or in the alternative to affirm the judgment of the Court of Appeals of Kentucky on the ground that it is manifest that the questions upon which the decision of the cause depends are so insubstantial as not to need further argument.

I. THE STATE LAW INVOLVED AND THE NATURE OF THE CASE.

A. The Relevant Statutes And Regulations.

This appeal questions the constitutionality of Section 141.120 of the Kentucky Revised Statutes and Kentucky Administrative Regulations as set forth in

103 Kentucky Administrative Regulation 16:090 and 103 Kentucky Administrative Regulation 16:120.

Kentucky Revised Statute 141.120 provides the methodology by which multi-state corporations pay income tax for business activities carried on in the state of Kentucky. (Appendix A.) The provisions of Kentucky Revised Statute 141.120 were adopted by the Kentucky legislature in 1966 from the Uniform Division of Income for Tax Purposes Act ("UDIPTA"). The provisions of Kentucky Revised Statute 141.120 require that the factors of payroll, property and sales be used in a three-factor formula to determine corporate income subject to Kentucky tax.

The legislature, in enacting the three-factor UDIPTA formula, recognized the uniqueness of a public service company's business. The legislature made provision for the Revenue Cabinet to define, by regulation, the sales and property factors as applied to a public service company. Kentucky Revised Statute 141.120 (10)(b). The Revenue Cabinet did promulgate regulations for public service companies. At the time the Revenue Cabinet promulgated these regulations, special provisions defining the three factors were enacted for trucklines, buslines and airlines. 103 Kentucky Administrative Regulation 16:120. (Appendix B.)

As a public service company in the trucking business, Liquid Transporters' income was apportioned pursuant to the three-factor UDIPTA formula, with the three factors defined as set forth in 103 Kentucky Administrative Regulation 16:120. The three-factor

formula as defined for trucklines was applied to Liquid Transporters as follows:

$$\text{Kentucky Business Income} = \frac{\text{Kentucky Property}}{\text{All Property}} + \frac{\text{Kentucky Payroll}}{\text{All Payroll}} + \frac{\text{Kentucky Sales}}{\text{All Sales}} \times \text{Total Business Income}$$

Liquid Transporters argues that the application of the three-factor formula results in an abnormally high percentage factor. When this percentage factor is added to the factors applied in other states where corporate income tax is paid, Liquid Transporters contends that it resulted, for several years of the audit period, in a factor exceeding one hundred percent. Liquid Transporters claims that this use of the three-factor formula in Kentucky violates its rights under the Due Process and Commerce Clauses because of the resulting high percentage factor. Liquid Transporters further argues that, as a matter of law, Kentucky is required to apply a formula in conformity with formulas used in other states. Liquid Transporters argues that the "uniqueness" of the Kentucky formula makes it violative of the Due Process and Commerce Clauses of the federal constitution.

B. The Proceeding Below.

The Revenue Cabinet audited Liquid Transporters for the years 1973 through 1978. In assessing a corporate income tax deficiency, the Revenue Cabinet applied the three-factor UDIPTA formula as defined in 103 Kentucky Administrative Regulation 16:120.

Liquid Transporters alleged that it had petitioned the Revenue Cabinet for a modification of the formula pursuant to Kentucky Revised Statute 141.120(9) by attaching a copy of its alternate formula to its 1971 income tax return. This formula used a single factor: mileage in Kentucky as the numerator and all mileage as the denominator. For the years of 1973 through 1978, Liquid Transporters paid corporate income tax based upon the use of the single factor formula. Liquid Transporters contested the Revenue Cabinet's assessment and filed an action with the Kentucky Board of Tax Appeals ("Board"). The Board, in upholding the income tax assessment, ruled on July 23, 1984, that Liquid Transporters had failed to properly petition the Revenue Cabinet for a modification of the three-factor formula and that Liquid Transporters had failed to meet the requisite burden of proof to show that the formula used by the Revenue Cabinet did not fairly measure income generated by Liquid Transporters in Kentucky. (Appendix C.) Liquid Transporters appealed the Board's decision to the Jefferson County, Kentucky, Circuit Court. The Jefferson Circuit Court affirmed the decision of the Board in a decision dated May 23, 1985. (Appendix D.) The decision was appealed to the Court of Appeals of the State of Kentucky. In an order dated November 7, 1986, the decision was affirmed. 721 S. W. 2d 722 (1986). (Appendix E.) A motion for discretionary review, filed by Liquid Transporters with the Supreme Court of Kentucky, was denied in an order dated January 13, 1987. (Appendix F.)

II. ARGUMENTS

1. No Right of Review by the Court Will Be Granted When the Case at Issue Was or Could Be Decided on an Adequate, Non-Federal Basis.

Kentucky Revised Statute 141.120(9) requires that a corporation objecting to the use of the three-factor formula file a petition with the Revenue Cabinet to request an alternative method be used to apportion corporate business income. The petitioning corporation must show the following:

> 1) that the three-factor formula does not fairly reflect income generated by the corporation in the State of Kentucky; and
>
> 2) that a proposed alternate formula proferred by the corporation fairly reflects the income generated by his business activities in Kentucky.

The Board correctly ruled from the evidence before it that Liquid Transporters had waived its right to use an alternate formula as it had failed to properly petition the Revenue Cabinet for a modification of the formula. This ruling was affirmed by the Jefferson Circuit Court. While the Court of Appeals did not affirm the Board's decision on this issue, the Court did agree that Liquid Transporters had failed to properly petition the Revenue Cabinet.[1]

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[1]The Court stated: "Initially, the appellant argues that the three-factor formula set forth in KRS 141.120 is, on its face, unconstitutional. . . . Before addressing such issue, this Court notes that during the years in question, with the exception of 1971, the appellant failed to petition the Department of Revenue for an al-

(Footnote Continued on Next Page)

No right of review lies where a case was or could have been decided on an adequate, non-federal basis. *Jean* v. *Nelson,* 105 S. Ct. 2992 (1985). Despite the language in the Court of Appeal's decision this case could have been decided purely on procedural grounds. Liquid Transporters has failed to take advantage of procedural relief granted by state statute and cannot assert sufficient standing to sustain this appeal.

2. This Case Presents No Substantial Federal Question Not Previously Decided by This Court.

It is a well-established legal maxim that the state has the authority to tax the multi-state corporation if that corporation has sufficient contacts or nexus with the taxing state. *Wisconsin* v. *J. C. Penney Company,* 311 U. S. 435 (1940). The right to tax arises from the sovereign powers granted the states by the Constitution of the United States. *M'Culloch* v. *Maryland,* 17 U. S. (4 Wheat.) 316 (1819). This is not to say that constitutionally there are no guidelines associated with the state's right to tax a multi-state corporation. The method or manner of assessing tax must, under

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(Footnote Continued From Preceding Page)

ternative method of taxation as provided for in KRS 141.120(9). . . . Only for the taxable year 1971 did the appellant make an attempt to file such a petition, which was simply attaching the petition to the back of the 1971 income tax return. Although it is arguable that this failure effectively estops the appelant from arguing that the method of allocation and aportionment utilized by the Cabinet is unconstitutional, we find it unnecessary to reach this issue, given our ruling that the statutory scheme is both fair and reasonable, and not in violation of either the Commerce or Due Process Clauses of the Constitution." (721 S. W. 2d at 724).

both the Due Process Clause and the Comerce Clause, be fair. *Container Corporation of America* v. *Franchise Tax Board*, 463 U. S. 159, 169 (1983); *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U. S. 653, 663 (1948). These constitutional parameters have been interpreted to require the state to apportion income to fairly reflect the business activities carried on and the benefits received from the taxing state. *Container, supra; Central Greyhound, supra.* The UDIPTA formula and the three-factor formula have been recognized by this Court as meeting the fairness criteria. *Container, supra; Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U. S. 123 (1931). While recognizing the merits of the UDIPTA formula, this Court has not dictated that it is the only fair method available to the states to apportion corporate income subject to tax. *Container, supra.* There is no requirement that a state's method of assessing corporate income subject to tax on the multi-state corporation be uniform. *Container, supra,* at 171; *Moorman Manufacturing Co.* v. *G. D. Bair*, 437 U. S. 267, 274 (1978); *Wisconsin* v. *J.C. Penney, supra.* There is also no prohibition against a state using a factor or factors which cumulatively result in the corporation having a percentage factor used to apportion income that exceeds one hundred percent. *Moorman, supra,* at 278. The Court, however, has mandated that if all states applied the same formula to apportion corporate income, the percentage factor applied to a corporation's income cannot exceed one hundred percent. *Moorman, supra,* at 267. If all states applied the Kentucky three-factor

UDIPTA formula to multi-state trucklines, the percentage factor would not exceed one hundred percent.

Liquid Transporters has incorrectly cited *Greyhound, supra,* in support of its contention that Kentucky must use the single factor of mileage to apportion income. It was held in *Greyhound, supra,* that the single mileage factor was appropriate. However, the court in *Greyhound, supra,* did not rule that the mileage factor was the only method individual states could use to apportion income.

This Court has previously resolved the issue asserted by Liquid Transporters. This Court has repeatedly acknowledged the right of a state to determine the method of apportioning income. The Court of Appeals of the State of Kentucky has affirmed the use of the UDIPTA three factor formula as modified for trucklines on the basis that the formula fairly reflected Liquid Transporers' business activities in Kentucky. The fact that the UDIPTA formula applied to trucklines fairly reflects business activities carried on in the state of Kentucky presents no substantial federal question.

III. CONCLUSION

Wherefore, the Revenue Cabinet, as appellee, respectfully submits that the questions upon which this case depends 1) can be decided on adequate non-federal grounds and 2) are so insubstantial that they need no further argument, and appellee respectfully moves this Court to dismiss this appeal, or in the alternative, to affirm the judgment entered in the cause by the Court of Appeals of Kentucky.

Respectfully submitted,

CELIA M. DUNLAP
Counsel for Appellee
Revenue Cabinet
Commonwealth of Kentucky

CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Motion of Appellee to Dismiss or Affirm were served this 8th day of May, 1987, in compliance with the Rules of the Supreme Court of the United States, by depositing three copies in a United States post office box or mailbox, with first-class postage prepaid, addressed to Hon. Joseph L. T. Ardery, Brown, Todd & Heyburn, 1600 Citizens Plaza, Louisville, Kentucky 40202. All parties required to be served have been served.

Celia M. Dunlap

CELIA M. DUNLAP

Attorney for Appellee,
Revenue Cabinet
Commonwealth of Kentucky

APPENDIX

APPENDIX A

KRS 141.120 Division of Income of Interstate Business for Tax Purposes.

(1) As used in this section, unless the context requires otherwise:

(a) "Business income" means income arising from transactions and activity in the regular course of a trade or business of the taxpayer and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations;

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is managed;

(c) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or payable to employees for personal services;

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank investment company, or any type of insurance company;

(e) "Nonbusiness income" means all income other than business income;

(f) "Public service company" means any business entity subject to taxation under KRS 136.120;

(g) "Sales" means all gross receipts of the taxpayer not allocated under subsections (3) through (7) of this section;

(h) "State" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(2) Any corporation which is required by KRS 141.010 (14)(b) to allocate and apportion its net income shall allocate and apportion its net income as provided in this section.

(3) Rents and royalties from real or tangible personal property, capital gains and losses, interest, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in subsections (4) through (7) of this section.

(4) (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible property are allocable to this state if and to the extent that the property is utilized in this state; or in their entirety if the taxpayer's commercial domicile is in this state and the taypayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period of the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, the tangible personalty is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(5) (a) Capital gains and losses from sales or other dispositions of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales or other dispositions of tangible personal property are allocable to this state if the property had a situs in this state at the time of sale, or the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales or other dispositions of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

(6) Interest is allocable to this state if the taxpayer's commercial domicile is in this state.

(7) (a) Patent and copyright royalties are allocable to this state in and to the extent that the patent or copyright is utilized by the payer in this state; or if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or of the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized to the extent that printing or other publication originates in the state. If the basis of receipts from copyright does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(8) All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor

plus the sales factor, and the denominator of which is three (3).

(a) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.850 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero such property shall be valued by the department under regulations promulgated by the department. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals, provided that such rental and such sub-rentals are reasonable. If the department determines that the annual rental or sub-rental rate is unreasonable, or if a nominal or zero rate is charged, the department may determine and apply such rental rate as will reasonably reflect the value ~~of the~~ property rented by the taxpayer.

2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(b) The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the taxpayer for compensation, and

the denominator of which is the total compensation paid or payable everywhere during the tax period. Compensation is paid or payable in this state if:

1. The individual's service is performed entirely within the state; or

2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

3. Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the state from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(c) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period. Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government.

3. Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed

in this state than in any other state, based on costs of performance.

(9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(10) Public service companies and financial organization required by KRS 141.010(14)(b) to allocate and apportion net income shall allocate and apportion such income as follows:

(a) Nonbusiness income shall be allocated to this state as provided in subsections (4) through (7) of this section;

(b) Business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three (3). The payroll factor shall be determined as provided in subsection (8) (b) of this section. The property factor and sales factor shall be determined as provided by regulations promulgated by the department.

APPENDIX B

103 KAR 16:120. Apportionment and allocation; truck-lines, bus lines; airlines.

RELATES TO: KRS 141.120

PURSUANT TO: KRS Chapter 13a

NECESSITY AND FUNCTION: This regulation, under authority of KRS 141.120(10)(b), specifies how the factors for apportioning the income of interstate truckline, bus line, and airline companies are to be determined.

Section 1. General. (1) Business income of multi-state corporate truckline, bus line, or airline, shall be apportioned to Kentucky by multiplying the income by a fraction, the numerator of which is the sales factor plus the property factor plus the payroll factor, and the denominator of which is three (3).

(2) Nonbusiness income shall be allocated to Kentucky by KRS 141.120(3) to (7) and 103 KAR 16:060.

Section 2. Sales Factor. "Sales" means operating income as defined by the Interstate Commerce Commission (Civil Aeronautics Board for airlines). The sales factor is a fraction, the numerator of which is operating income assigned to Kentucky and the denominator of which is total operating income. Kentucky operating income is determined as follows: Total operating income shall be multiplied by a fraction the numerator of which is miles in Kentucky and the denominator of which is total miles operated.

Section 3. Property Factor. The property factor is a fraction, the numerator of which is the average value of tangible property sitused in Kentucky that is owned and used, and/or leased and used. The denominator is the average value of all tangible sitused property that is owned and used and/or leased and used. The average value of

tangible sitused property during the tax period shall be determined under the provisions of 103 KAR 16:080. The value of over-the-road equipment and of aircraft shall be excluded in determining the average value of both Kentucky and total property.

Section 4. Payroll Factor. The payroll factor shall be determined under the provisions of KRS 141.120(8)(b) and 103 KAR 16:090. (IC-12; 1 Ky. R. 224; eff. 1-8-75.)

APPENDIX C

KENTUCKY BOARD OF TAX APPEALS

File No. K82-R-56

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

OPINION

This appeal is from a final ruling of the Kentucky Revenue Cabinet where the appellant, Liquid Transporters, Inc., was assessed a deficiency of additional Kentucky corporation income taxes for the years 1973 through 1978. During the years in question the appellant reported its income to Kentucky based upon its miles (truck) in Kentucky against its total miles everywhere. However, the Cabinet, in its audit used a three factor formula to determine their income. This formula is based on mileage in Kentucky, as compared to total mileage, as one factor and also based on taxpayer's property and payroll in the state and outside the state as factors.

The appellant contends that the application of the Cabinet's apportionment method is unfair and:

1. Violates the Due Process rights of appellant;
2. Violates the Commerce Clause rights of appellant;
3. Violates legislative intent of The Uniform Division of Income for Tax Purposes Act (UDITPA) (KRS 141.120.

The appellant also claims that the Cabinet's assessment as to 1973 is barred by the statute of limitations.

Appellee argues that the appellant has waived its right to question the three factor formula by failing to petition for a different apportionment formula in accordance with KRS 141.120(9); and argues, of course, that the three factor formula is constitutional and fair.

This Board agrees that appellee failed to properly petition for the use of a different apportionment formula under KRS 141.120(9). However, the Board does not agree that appellant waived its right to question the application of the three factor formula.

On the primary issue, this Board is of the opinion that the three factor formula used by the Cabinet does fairly measure the income generated by appellant's business activities in Kentucky. The recent Supreme Court Case, *Container Corporation of America* v. *Franchise Tax Board,* answers and puts to rest the constitutional arguments made by this appellant.

Finally, the Board agrees with appellee on the Statute of Limitations questions. The six year statute of limitation clearly applies in this case. Therefore, the 1973 tax year will remain in the assessment.

Counsel for the appellee are directed to prepare proposed findings of fact, conclusions of law, and proposed order pursuant to this opinion for consideration by the Board within 30 days from the date of this opinion, with copy to be served upon appellee's counsel for comment within 15 days thereafter, It is clearly understood that the Board will prepare its own findings of fact and conclusions of law after the proposed findings and conclusions and comments thereto have been submitted.

This 9th day of April, 1984.

Kentucky Board of Tax Appeals

(s) Garland W. Howard
Garland W. Howard, Chairman

Attest:

(s) Ellis A. Merrifield
Ellis A. Merrifield, Clerk

KENTUCKY BOARD OF TAX APPEALS

File No. K82-R-56

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Order No. K-10305

FINDINGS OF FACT

1. This appeal is from a final ruling of the Kentucky Revenue Cabinet where the Appellant, Liquid Transporters, Inc., was assessed a deficiency of additional Kentucky corporation income taxes for the years 1973 through 1978.

2. The Appellant, Liquid Transporters, Inc., is in the business of transporting bulk commodities through authorities granted it by the Interstate Commerce Commission and the Kentucky Public Utilites Commission. During the years in question the Appellant reported its income to Kentucky based upon its miles (track) in Kentucky against its total miles everywhere. Appellee, in its audit, used the three factor formula prescribed by statute and regulation to determine their income. This formula is based on mileage in Kentucky, as to the mileage, as one factor and also based on taxpayer's property and payroll in the state and outside the state as factors.

3. The Appellant's method of determining its tax liability to the State of Kentucky does not reflect the full extent of its business activities in this state.

Forty percent of Appellant's miles occur in Kentucky. It has its corporate headquarters and commercial domicile here in Kentucky. It owns and leases real property here. It operates under the worker's compensation and unemployment insurance laws of this state. All dispatching is done from Kentucky. Most of its shipments originate from this state. It solicits its business from this state. It has its bank accounts and accountants in this state.

4. The three factor formula utilized by the Revenue Cabinet fairly measures the income generated by Appellant's business activities in the State of Kentucky.

5. Under the statute, KRS 141.120, a taxpayer may petition for use of some alternative to the statutory three factor formula. During the years in issue the Appellant made no such petition.

6. For the years 1973 the Appellant understated its taxable net income for Kentucky by more than 25%.

7. While the Kentucky legislature directed that the three factor formula should be applied to public service companies, it specifically directed that the Revenue Cabinet should develop regulations with respect to the determination of the property factor and the sales factor. KRS 141.120(10)(d). The regulations which were promulgated for trucking companies provided that the sales factor would be determined by mileage driven in the state divided by mileage driven everywhere. 103 KAR 16:120(2). The regulation also provides that the property factor will be determined by the value of the Kentucky property divided by the value of all property with the value of all over-the-road equipment excluded from the computation. 103 KAR 16:120(3).

8. There is some testimony that it was at the request of the trucking industry that over-the-road equipment was excluded from the property computation.

9. The primary rationale for excluding over-the-road equipment from the property factor is that, since this type of property must be assigned by mileage, inclusion of over-the-road equipment in the property factor would give undue emphasis to mileage in the overall formula. Mileage, already makes up a full third of the formula through its use as the determining element in the sales factor.

10. In this case, it would be difficult to value Appellant's leased over-the-road equipment. This is because the leases in question include elements which are not properly attributable to the value of the leased equipment. For instance, in its typical lease, Liquid Transporters was paying not only for the property leased, but for a driver, insurance, repair and maintenance, fuel, oil, tires, batteries. tolls, taxes, licenses, substitute equipment, and other operating necessities for the equipment. If these leases were capitalized at eight times their value (the stautory method of capitalization) a gross distortion in the property factor would result.

11. By applying a three factor formula in which a full third of the formula is based on mileage and which fairly takes into account the taxpayer's property and payroll in the state and outside the state, Kentucky has arrived at a fair and reasonable income allocation and apportionment method which reflects the extent of Appellant's business activity in Kentucky.

CONCLUSIONS OF LAW

The burden of proof is upon the party seeking to vary from the statutory formula. *Ruby Construction Co., Inc.*

v. *Revenue,* Ky., App., 578 S.W.2d 248 (1979). The Appellant here has not carried its burden.

Since the three factor statutary formula fairly apportions the income of Appellant subject to Kentucky income tax, the assessment must be upheld and the Cabinet's final ruling affirmed.

Appellant's returns understated its taxable net income by more than 25%. Therefore the six year statute of limitations applies pursuant to KRS 141.210, and the assessment for the year 1973 is proper.

This 25th day of July, 1984.

Kentucky Board of Tax Appeals

(s) Garland W. Howard
Garland W. Howard, Chairman

Attest:

(s) Ellis A. Merrifield
Ellis A. Merrifield, Clerk

APPENDIX D

JEFFERSON CIRCUIT COURT

TWELFTH DIVISION

No. 84CI 06717

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

JUDGMENT AFFIRMING AND REVERSING IN PART MEMORANDUM OPINION

On July 25, 1984, the Kentucky Board of Tax Appeals affirmed the assessment against Liquid Transporters of additional Kentucky corporation income taxes for the years 1973 through 1978. Liquid Transporters appeals.

Appellant is represented by the Honorable Joseph L.T. Ardery and the appellee is represented by the Honorable Ross Carter. Both parties have filed exhaustive briefs and have orally argued this case on March 1, 1985.

In appeals pursuant to KRS 133.370, this Court is limited in scope. Under the statute, these actions are disposed of in a summary manner and the review is limited to determining whether or not:

"(a) The Board acted without or in excess of its powers;

(b) The Order, Decision or Award was procured by fraud;

(c) The Order, Decision or Award is not in conformity to the law;

(d) The Findings of Fact are an issue whether such Findings of Fact Support the Order, Decision or Award."

If the Findings of Fact are supported by substantial evidence and if the assessment conforms to the law, then the Decision must be affirmed. (*Trimble County Board of Supervisors* v. *Mullikin,* Ky., 438 S. W. 2d 524 (1968); *Department of Revenue* v. *Anaconda American Brass Company,* Ky., 435 S. W. 2d 65 (1968).

The appellant, Liquid Transporters, Inc. (hereinafter referred to as Transporters) carry bulk commodities by authorization of the Interstate Commerce Commission and the Kentucky Public Utilities Commission. From 1973 through 1978, Transporters reported its income to the State of Kentucky based upon its truck miles traveled in Kentucky as comparide to its total miles traveled everywhere. The Department of Revenue found a deficiency for each of the years using the formula promulgated in regulation. (103 KAR 16:120(2)). Transporters makes the following arguments:

1. The Kentucky Allocation and Apportionment Formula does not fairly apportion the income of Transporters subject to the tax.
2. The Kentucky apportionment method violates the due process rights of Transporters.
3. The appellant did not waive its constitutional rights by failing to properly petition for the use of the straight mileage apportionment.
4. The 1973 assessment against Transporters is barred by the Statute of Limitations.

These arguments are addressed separately.

I. THE KENTUCKY ALLOCATION AND APPORTIONMENT FORMULA FAIRLY APPORTIONS THE INCOME OF APPELLANT SUBJECT TO KENTUCKY INCOME TAX.

Transporters argues that the Board should have followed the case of *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S. 653, 92 L.Ed. 1633 (1947). They contend that this case holds that the taxing scheme set up by the State be struck down by the Court.

Although Transporters cites certain phrases from the case, the ruling does not support the contention that the apportionment formula is improper. In Central Greyhound, a trucking company was taxed on its "gross receipts" where the trucks drove not only in New York but also in Pennsylvania and New Jersey. The Court held that New York cannot tax the company on 100% of the "gross receipts" when only 57.47% of the mileage was driven in New York. The tax must be "fairly apportioned" to the business done within the State by a "fair method of apportionment".

This case in no way holds that the straight mileage formula is *required* or that Kentucky's formula is not fair just because it is not based solely on mileage. The tax is fairly apportioned to the business done within the State. (*Container Corporation of America* v. *Franchise Tax Board,* 103 S.Ct. 2933 (~~1983~~)), 77 L. Ed. 2d 545; *Moorman Manufacturing Company* v. *Bair,* 98 S. Ct. 2340 (1978)).

The Container and Moorman cases uphold either single or multiple factor formulas used for apportionments. The Container case even proclaims that the constitution imposes no single fomula in the States. The formula must be fair and externally consistent. The three-factor formula based in equal parts as to payroll, sales and property has been approved.

II. KENTUCKY'S APPORTIONMENT METHOD DOES NOT VIOLATE THE DUE PROCESS RIGHTS OF TRANSPORTERS.

The facts found in this case not only show that Transporters traveled 40% of all of its miles in Kentucky, but it has its corporate headquarters and commercial domicile here. It owns and leases real property here. It benefits from the Worker's Compensation and Unemployment Insurance laws of this State. It does all its dispatching and most of its shipping from Kentucky. It solicits business within the State. It has bank accounts, accountants, and numerous other contacts within the Commonwealth of Kentucky, which it does not have with other States. In *Moorman Manufacturing Company* v. *Bair, supra,* the Court handed down two restrictions to states taxing interstate commerce done within the individual state is order to meet the due processs requirements of the Fourteenth Amendment of the U.S. Constitution. The restrictions were that:

1) No tax would be imposed, unless there is some minimal connection between those activities and the taxing state.

2) The income attributed to the state for tax purposes must be rationally related to values connected with the taxing state.

The Commonwealth's three-factor formula satisfies the above restrictions and fairly measures the income generated by appellant's business activities in this State. The formula which is applied for determining Transporters' income is basically as follows, to-wit:

$$\frac{\text{Kentucky Property}}{\text{All Property}} \text{ plus } \frac{\text{Kentucky Payroll}}{\text{All Payroll}} \text{ plus } \frac{\text{Kentucky Sales}}{\text{All Sales}}$$

Divide the sum by three and the result is equal to total "taxable" business income.

KRS 141.120(10(d) is a promulgating authority for development of regulations which were adopted by the Revenue Cabinet. The regulations privide that the sales factor would be determined by mileage driven in Kentucky divided by mileage driven everywhere. (103 KAR 16; 120(2)). The property factor would be determined by the value of all over-the-road equipment excluded from the computation. Transporters contends that this exclusion is unfair. However, if it were included, then logically it must be assigned mileage since a good portion of the over-the-road equipment is used outside the State and inclusion of the over-the-road equipment in the property factor would give undue emphasis to mileage in the overall formula. It is also noted that mileage is already considered in a third of the formula's makeup.

The Court cannot conclude that the three-factor formula which fairly takes into account Transporters nexus and relationships with the Commonwealth is unfair. It is also noted that the burden is on the party seeking to use some other method to show that the formula distorts or is unfair. (KRS 141.120(9); *Ruby Construction Company* v. *Revenue,* Ky. App., 578 S. W. 2d 248 (1979)). This has not been done and the Court concludes that the apportionment method does not violate Transporters due process rights.

III. BY FAILING TO PETITION IN ACCORDANCE WITH 141.120(9) FOR THE YEARS IN QUESTION, TRANSPORTERS HAS WAIVED ITS RIGHT TO QUESTION THE APPLICATION OF THE THREE-FACTOR FORMULA.

The Revenue Department argues that while the appellant has the right to petition for relief under KRS 141.120 (9), it waived that right by failing to file the proper petition. This, it contends, is a condition precedent in order to take advantage of KRS 141.120(9) and thus these rights were waived. (28 Am. Jur. 2d, Estoppel & Waiver, Sec. 164).

The provisions of Section 9 of KRS 141.120 provide as follows:

> (9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this State, taxpayer may petition for or the department may require in respect to all or any part of the taxpayer's business activity if reasonable (a) separate accounting (b) the exclusion of any one or more of the factors (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

It is undisputed that Transporters did not petition the Department pursuant to this particular section for any of the years in question.

Transporters, without complying with this "relief" section, cannot now be heard to come forward and some five years later complain about the allocation formula. In this respect also, the Court believes that the Decision of the

Board of Tax Appeals is in conformity with the law. (KRS 141.120(9)).

IV. THE 1973 ASSESSMENT SHOULD BE BARRED BY THE STATUTE OF LIMITATIONS

Transporters filed its corporate income tax return for 1973 on March 15, 1974. Kentucky assessed additional tax with respect to 1973 on August 1, 1979. This was a period in excess of four years after the filing date.

The provisions of KRS 141.210 with respect to the assessment of such taxes provides in pertinent part:

> 1. "As soon as practicable after each return is received, the department shall examine and audit it. If the amount of tax as computed by the department is greater than the amount returned by the taxpayer, the excess shall be assessed by the department within four years from the date the return was filed, except as hereinafter provided. . . .
> a notice of the assessment shall be mailed to the taxpayer . . . (c) in the case of a return where a corporation understates its taxable net income or omits from taxable net income an amount properly includable therein or both which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be assessed at any time within six years after the return was filed".

Transporters contends the Statute of Limitations expired in four years while Revenue claims it was six years because Transporters had understated its "taxable" income by an excess of 25%.

The Court observes that KRS 141.210(c) was amended in 1974 (effective June 21, 1974) adding the word "taxable"

to the statute. So at the time that Transporters filed its return in this case, the law was different. Prior to 1974, subsection (c) provided a six year Statute of Limitation when "net income" was understated by 25%. That was not the situation when the tax return was filed. Transporters did not understate their "net income" as envisioned in subsection (c) which was the prevailing law at that time. The amendment of June 26, 1974 should not be given retroactive application to the 1973 taxes.

JUDGMENT

For the reasons set forth hereinafter in the Memorandum Opinion, it appearing that there is substantial evidence to support the Findings of Fact and Conclusions of Law and the ruling of the Kentucky Board of Tax Appeals and further that the Board did not err as to the assessment of the 1973 tax and the Court being further advised, the Decision of the Kentucky Board of Appeals is affirmed in part and reversed in part as it applies to the 1973 assessment. This is a final Order.

(s) Edwin Schroering, Jr.
Edwin A. Schroering, Jr., Judge

Date May 23, 1985

Copy To:

Joseph L.T. Ardery
Ross Carter

APPENDIX E

COURT OF APPEALS OF KENTUCKY

No. 85-CA-1850-MR
721 S. W. 2d 722

LIQUID TRANSPORTERS, INC., - - - - *Appellant,*

v.

REVENUE CABINET, Commonwealth of Kentucky, - - - - - - *Appellee.*

REVENUE CABINET, Commonwealth of Kentucky, - - - - - *Cross-Appellant,*

v.

LIQUID TRANSPORTERS, INC., - - *Cross-Appellee.*

November 7, 1986.

Discretionary Review Denied by Supreme Court January 13, 1987.

COOPER, Judge.

This is an appeal and cross-appeal from a judgment of the circuit court upholding a ruling of the Kentucky Board of Tax Appeals (hereinafter the Board). That ruling held that the statutorily prescribed method for apportioning business income subject to taxation for a corporation engaged in business within the Commonwealth was properly applied to the appellant. On direct appeal, the issue is whether the procedure set forth in the statute is an unconstitutional violation of both the Commerce and Due Process

Clauses of the United States Constitution. On cross-appeal, the issue is whether the circuit court acted correctly in ruling that the appellee's attempt to assess taxes for the 1973 year was effectively barred by the statute of limitations. KRS 141.210. Reviewing the record below, we affirm.

The essential facts giving rise to this litigation are as follows: In July of 1984, the Board affirmed a ruling issued by the appellee. Revenue Cabinet, Commonwealth of Kentucky, assessing additional taxes against the appellant, Liquid Transporters, Inc., for the years 1973-78. The assessment resulted from the appellee's following the procedure set forth in KRS 141.120(8), and the regulation promulgated under the statute, 103 KAR 16:120(2). Under authorization of the Interstate Commerce Commission and the Kentucky Public Utilities Commission, the appellant is authorized to carry bulk commodities throughout Kentucky and neighboring jurisdictions. The appellant reported its income in the years in question on the basis of truck mileage traveled in Kentucky in proportion to its total truck mileage traveled throughout the United States. This basis for reporting income differed from that set forth in the statute and also the regulation. As a result, the Board affirmed the additional assessment issued by the Revenue Cabinet. This finding was affirmed by the circuit court.

The circuit court specifically found that the formula set forth in the statute and the regulation resulted in a *fair* assessment of corporate income tax owed by the appellant. Additionally, it found that the apportionment formula set forth in the statute did not violate the appellant's constitutional right of due process. And, it ruled that the appellant had waived its right to question the constitutionality of the apportionment and allocation formula set forth in the statute as a result of its failure to petition the ap-

pellee for an alternative method of taxation in the years in question. KRS 141.120(9). Finally, it ruled that the attempt by the Revenue Cabinet to assess additional taxes for 1973 would be barred by the statute of limitations. KRS 141.120. It is from such judgment that the appellant now appears and the appellee cross-appeals.

Initially, the appellant argues that the three-factor formula set forth in KRS 141.120 is, on its face, unconstitutional. Specifically, it argues that applying such a formula to the income it earned for the years in question resulted in an unfair and overlapping system of taxation with respect to the amount of corporate income tax it paid to sister states. Before addressing such issue, this Court notes that during the years in question, with the exception of 1971, the appellant failed to petition the Department of Revenue for an alternative method of taxation as provided for in KRS 141.120(9). That section states as follows:

> (9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) Separate accounting;
>
> (b) The exclusion of any one or more of the factors;
>
> (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Only for the taxable year 1971 did the appellant make an attempt to file such a petition, which was simply attaching the petition to the back of the 1971 income tax return. Although it is arguable that this failure effectively estops the appellant from arguing that the method of allocation and apportionment utilized by the Cabinet is unconstitutional, we find it unnecessary to reach this issue, given our ruling that the statutory scheme is both fair and reasonable, and not in violation of either the Commerce or Due Process Clauses of the Constitution.

Under the statutory scheme set forth in KRS 141.120, three factors are utilized in determining the amount of business income taxable by the Commonwealth: the percentage of property owned and operated in Kentucky to total property owned and operated by the corporation in question; the percentage of payroll paid out of this state to the total payroll of the corporation; and the percentage of Kentucky sales to total sales. This percentage is divided by three and multiplied by the total business income in determining the amount subject to Kentucky taxation. In effect, three factors—that of payroll, property, and sales — are utilized in determining the amount of business income subject to Kentucky taxation rather than simply one factor, such as the amount of miles driven within the state in proportion to total mileage driven.

Although this three-factor formula has been upheld and approved by the Court in *Butler Brothers* v. *McColgan,* 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991 (1942), as well as in *Container Corporation of America* v. *Franchise Tax Bd.,* 463 U. S. 159, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983), the appellant apparently argues that a one-factor formula, that of straight mileage apportionment, should be utilized. As authority for this argument it cites the decision of the Court in *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S.

653, 68 S. Ct. 1260, 92 L. Ed. 1633 (1947). We find *Central Greyhound* distinguishable. In effect, that Court ruled that the method for appropriating income to a state must be a fair method. By no means did it mandate a straight mileage method of apportionment. Rather, the Court ruled that under the existing taxing scheme of New York, an unapportioned gross receipt tax levied on an interstate business violated the Commerce Clause.

In *Container Corp., supra,* the Court endorsed the three-factor formula and stated that an indication of its fairness in a specific context is whether it exhibits internal and external consistency. By internal consistency, the Court stated that if such method were applied in every jurisdiction, it would result in no more than all the taxpayer's business income being taxed. Here, the appellant has failed to demonstrate that if the statutory scheme set forth in the statute were employed in all jurisdictions, more than a hundred percent of the taxpayer's business income would be taxed. Furthermore, as that Court stated: "a fairly apportioned tax would not be found invalid simply because it differed from the prevailing approach adopted by the States. . . ." at p. 557. And, it held that only a constituted mandated method of taxation could eliminate all overlapping taxation.

Besides affirming that an apportionment formula should possess internal consistency, the *Container Corp., supra,* Court held that it must possess an external consistency, a characteristic difficult to define. Specifically, the Court stated as follows:

> [T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not

> have its source in the taxing State . . . Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted in that State'." *Id.* at p. 556.

Reviewing the record before this Court, we do not believe that the appellant has presented clear and cogent evidence that the business income generated by it and attributed to this Commonwealth is, in fact, "out of all appropriate proportion to the business transacted" within this state. Although the appellant argues that most of its revenue results from interstate travel in states other than Kentucky, the record reflects the fact that the appellant has its corporate headquarters and corporate domicile in this jurisdiction and both owns and leases real property here. Furthermore, it benefits from workers' compensation and unemployment insurance laws, and most of its bulk shipments originate from this state. Taken as a whole, we find that the evidence was substantial and supported the finding of both the Revenue Cabinet and the circuit court. As such, it will be upheld on appeal.

Finally, on cross-appeal, we concur with the findings of fact of the circuit court that the statute of limitations barred the assessment for the year 1973. In addressing such issue, the circuit court stated in its judgment the following:

"The provisions of KRS 141.210 with respect to the assessment of such taxes provides in pertinent part:

> 1. As soon as practicable after each return is received, the department shall examine and audit it. If the amount of tax as computed by the department is greater than the amount returned by the taxpayer, the

excess shall be assessed by the department within four years from the date the return was filed, except as hereinafter provided . . . a notice of the assessment shall be mailed to the taxpayer . . . (c) in the case of a return where a corporation understates its taxable net income or omits from taxable net income an amount properly includable therein or both which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be asserted at any time within six years after the return was filed.

Transporters contends the Statute of Limitations expired in four years while Revenue claims it was six years because Transporters had understated its "taxable" income by an excess of 25%.

The Court observes that KRS 141.210(c) was amended in 1974 (effective June 21, 1974) adding the word "taxable" to the statute. So at the time that Transporters filed its return in this case, the law was different. Prior to 1974, subsection (c) provided a six year Statute of Limitations when "net income" was understated by 25%. That was not the situation when the tax return was filed. Transporters did not understate their "net income" as envisioned in subsection (c) which was the prevailing law at that time. The amendment of June 26, 1974 should not be given retroactive application to the 1973 taxes."

We concur with the court's ruling.

The judgment of the circuit court is affirmed.

All concur.

APPENDIX F

SUPREME COURT OF KENTUCKY

86-SC-994-D
(85-CA-1850-MR & 85-CA-2598-MR)

LIQUID TRANSPORTERS, INC. - - - - *Movant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - - *Respondent*

Jefferson Circuit Court
No. 84-CI-06717

ORDER DENYING DISCRETIONARY REVIEW

The motion of the movant for a review of the decision of the Court of Appeals is denied.

ENTERED January 13, 1987.

(s) Robert F. Stephens
Chief Justice